

Message Text

CONFIDENTIAL

PAGE 01 LONDON 20447 01 OF 02 171718Z
ACTION EB-04

INFO OCT-01 SS-04 ISO-00 EUR-03 CEA-01 NSC-04 NSCE-00
INR-01 FRB-03 INRE-00 CIAE-00 SSO-00 /021 W
----- 046755 /55

O R 171702Z DEC 76
FM AMEMBASSY LONDON
TO SECSTATE WASHDC IMMEDIATE 8895
TREASURY DEPT WASHDC IMMEDIATE
INFO AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY BONN
AMEMBASSY TOKYO
USMISSION OECD PARIS
USMISSION EC BRUSSELS

C O N F I D E N T I A L SECTION 01 OF 02 LONDON 20447

LIMDIS GREENBACK

DPPARTMENT PASS FEDERAL RESERVE BOARD

E.O. 11652: GDS
TAGS: EFIN,UK
SUBJECT: HMTREASURY COMMENTS ON THE UK BUDGET

REF: A) LONDON 20294 B) LONDON 20292

SUMMARY: HMTREASURY ECONOMIC ADVISER REPORTS KEY DETER-
MINENTS DURING THE COMING YEAR IN THE UK'S ECONOMIC PER-
FORMANCE WILL BE GROWTH OF EXPORTS AND IMPORTS, MANUFAC-
TURING INVESTMENT, AND THE SHAPE OF THE PHASE 3 INCOMES
POLICY. BECAUSE THE UK HAS AGREED TARGETS WITH THE IMF ON
PSBR AND DCE, A SUBSTANTIAL INCREASE IN WAGES ABOVE THE
PRESENT NORMS WILL HAVE AS A CONCOMITANT INCREASING UNEM-
PLOYMENT. BALANCE OF PAYMENTS ON THE OTHER HAND IS EXPEC-
TED TO SHOW CONTINUING IMPROVEMENT, CERTAINLY FROM NORTH
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 LONDON 20447 01 OF 02 171718Z

SEA OIL AND HOPEFULLY FROM INCREASED EXPORTS AND REDUCED
IMPORTS AS A RESULT OF THE DECLINE IN THE EXCHANGE RATE,
WITH POSSIBLE FURTHER BENEFITS FROM REVERSAL IN LEADS AND
LAGS. END SUMMARY

1. A SENIOR FINANCIAL ADVISER IN HMTREASURY HAD LENGTHY

DISCUSSION WITH FINANCIAL ATTACHE ON THE BUDGET MESSAGE, IMF BORROWING AND THE ECONOMIC OUTLOOK. SOURCE WHO PARTICIPATED IN BUDGET EXERCISE AND HELPED DRAFT MAJOR PORTIONS OF THE CHANCELLOR'S MESSAGE TO PARLIAMENT, REPORTED THAT IT WAS SUBSTANTIALLY REWRITTEN BETWEEN MONDAY AND WEDNESDAY OF THIS WEEK. HMT HAD INCLUDED ITEMS AIMED AT REDUCING OR CUTTING INDEX LINKED TRANSFER AND SOCIAL SECURITY PAYMENTS. ON TUESDAY, THE CABINET REFUSED TO ACCEPT THESE AND CHANGED SIGNIFICANT PORTIONS OF THE BUDGET MESSAGE. CURRENT HIGH LEVEL OF UNEMPLOYMENT WAS IN THE MINDS OF MANY CABINET MEMBERS, AND PROVOKED THEIR OPPOSITION TO MANY OF THE PROPOSED TREASURY ELEMENTS ORIGINALLY IN THE PACKAGE. TREASURY STAFFERS WERE BUSY REWRITING THE MESSAGE THROUGH WEDNESDAY MORNING IN AN ATTEMPT TO MAKE THE PACKAGE LOOK COHERENT AND WELL BALANCED.

2. SOURCE REDILY ACKNOWLEDGED THE PACKAGE DOES NOT BEGIN TO DEAL WITH THE UK'S STRUCTURAL DIFFICULTIES. THE DIAGNOSIS AND PRESCRIPTION OF WHAT NEEDS TO BE DONE ARE WELL KNOWN, (NOVEMBER 5, 1975 NEDO DOCUMENT ON APPROACH TO INDUSTRIAL STRATEGY AND THE PRIME MINISTER'S SEPTEMBER 28, 1976 SPEECH TO THE LABOUR PARTY CONFERENCE IN BLACKPOOL WERE SPECIFICALLY CITED IN DISCUSSION). THE PROBLEM IS ONE OF TAKING ACTION AND CARRYING THROUGH ON THE EXISTING ANALYSIS. NORTH SEA OIL PROVIDES A BREATHING SPACE BUT UNLESS THE HARD DECISIONS ARE TAKEN WITHIN THE NEXT 2 TO 3 YEARS AIMED AT SHIFTING UK RESOURCES BACK INTO INTERNATIONALLY COMPETITIVE MANUFACTURING AREAS, THE UK MAY BE DOOMED PERMANENTLY TO CONTINUED LOW GROWTH, LOW INCOME STATUS, ALTHOUGH NORTH SEA OIL

CONFIDENTIAL

PAGE 03 LONDON 20447 01 OF 02 171718Z

PROCEEDS COULD MASK THE REALIZATION OF THIS DIRE OUTLOOK FOR A FEW YEARS.

3. TURNING SPECIFICALLY TO HMTREASURY ECONOMIC FORECAST THROUGH END 77 (REFTEL B) SOURCE SAID THERE ARE TWO KEY ELEMENTS WHICH MUST BE WATCHED CRITICALLY. THE FIRST OF THESE IS THE 2ND HALF 1977 OVER SECOND HALF 76 FORECAST FOR EXPORTS OF GOODS AND SERVICES (DUE TO INCREASE 8-1/2 PERCENT IN REAL TMS) AND IMPORTS OF GOODS AND SERVICES (UP ONLY 1-1/2 PERCENT). TO JUSTIFY THESE FIGURES SOURCE CITES THE FALL IN STERLING EXCHANGE RATE WHICH HAS ENABLED UK EXPORTERS TO INCREASE THEIR PROFITS. THE EXCHANGE RATE IS COMPETITIVE. REAL DISPOSABLE INCOME WILL FALL 4-5 PERCENT IN FY 1977/78. RESOURCES WILL BE AVAILABLE. EXPORT GROWTH IS EXPECTED TO REFLECT THIS. QUESTIONED SHARPLY ABOUT THE LOW IMPORT GROWTH PROJECTION SOURCE SAID STERLING'S DECLINE SHOULD PLAY A ROLE HERE, WHATEVER THE ELASTICITIES MAY BE, AND SHOULD HELP

DIVERT DEMAND TO DOMESTICALLY PRODUCED GOODS. IN
ADDITION, THE UK SUSPECTS THERE HAVE BEEN LARGE ANTICIPA-

CONFIDENTIAL

NNN

CONFIDENTIAL

PAGE 01 LONDON 20447 02 OF 02 171720Z
ACTION EB-04

INFO OCT-01 SS-04 EUR-03 CEA-01 NSC-04 NSCE-00 INR-01
FRB-03 CIAE-00 INRE-00 ISO-00 SSO-00 /021 W
----- 046772 /43

O R 171702Z DEC 76
FM AMEMBASSY LONDON
TO SECSTATE WASHDC IMMEDIATE 8896
TREASURY DEPT WASHDC IMMEDIATE
INFO AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY BONN
AMEMBASSY TOKYO
USMISSION OECD PARIS
USMISSION EC BRUSSELS

C O N F I D E N T I A L SECTION 02 OF 02 LONDON 20447

LIMDIS GREENBACK

TORY PURCHASES OF IMPORTS (PHYSICAL LEADS)WHICH WILL NOW
BE REVERSED. IN ADDITION, NORTH SEA OIL IN 1977 WILL IN-
CREASINGLY HAVE AN IMPORT SUBSTITUTION EFFECT. THE RE-
SULT WILL BE A PROGRESSIVE IMPROVEMENT IN THE BALANCE OF
PAYMENTS DURING THE PERIOD 1977-78, WITH EVEN HIGHER SUR-
PLUS IN THE CLOSING YEARS OFTHIS DECADE, SUFFICIENT TO
ASSURE REPAYMENT OF THE IMF LOAN AND THE UK'S OTHER SHORT
AND MEDIUM-TERM OFFICIAL DEBT MATURING BY THE EARLY
1980'S.

4. THE SECOND KEY ELEMENT IN UK PERFORMANCE NEXT YEAR
WILL BEMANUFACTURING INVESTMENT, FORECAST TO INCREASE
19-1/2 PERCENT IN THE SECOND HALF 1977 OVER SECOND HALF
76 PERIOD. SOURCE ACKNOWLEDGED THAT IT REQUIRED AN OPTI-
MISTIC FRAME OF MIND TO ACCEPT THIS FIGURE AND POINTED
OUT THAT REDUCING INTEREST RATES WOULD BE VERY IMPORTANT
IN ACHIEVING TARGET. AT CURRENT RATES OF BORROWING FOR
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 LONDON 20447 02 OF 02 171720Z

INDUSTRY--SAY 16-17 PERCENT--POTENTIAL INVESTORS ARE REFRAINING FROM BORROWING AND HAVE FEARS ABOUT DOING SO WHEN INFLATION RATES ARE ANTICIPATED TO FALL IN THE FUTURE, FROM MID 1977 ONWARDS. IN ADDITION, GIVEN LOW PROFIT LEVELS, COMPANIES THAT ARE LIQUID AND CONSIDERING CAPITAL INVESTMENT MIGHT BE BETTER ADVISED TO INVEST THEIR FUNDS IN GILTS WHICH CURRENTLY YIELD A HIGHER NON-RISK RATE OF RETURN THAN THE COMPANIES THEMSELVES COULD GET THROUGH INVESTMENT IN ADDITIONAL PLANT AND EQUIPMENT.

5. THE THIRD KEY ELEMENT IN THE SUCCESS OF THE PROGRAM WILL BE THE THIRD STAGE OF INCOMES POLICY. WITH THE PSBR AND DCE TARGETS AGREED WITH THE IMF, ANY SHARP INCREASE IN EARNINGS LEVELS WILL BRING WITH IT AN INCREASE IN UNEMPLOYMENT. THE UNION LEADERS KNOW THIS; "HEALEY HAS BEEN RAMMING IT DOWN THEIR THROATS." THEY ALSO REALIZE THERE IS NO CHANCE OF THE UK IMPOSING IMPORT CONTROLS AS A PALLIATIVE GIVEN THE TERMS OF THE IMF LETTER.

6. WHEN QUERIED ABOUT TRANSLATION OF DCE TARGETS INTO M3, SOURCE REPLIED THAT BALANCE OF PAYMENTS TRENDS WOULD OF COURSE INFLUENCE THE M3 FIGURES, BUT HIS OWN BEST ESTIMATE WAS A GROWTH IN M3 OF 12 PERCENT IN FY 77/78 AND 13 PERCENT IN FY78/79. THERE ARE MANY UNCERTAINTIES. LOOKING AHEAD, CONFIDENCE WILL BE AN IMPORTANT FACTOR IN DETERMINING WHAT HAPPENS TO SAVINGS LEVELS AND TO INVESTMENT. IN ADDITION, HOWEVER, SOURCE REMARKED THAT DIRECT TAXES ARE FAR TOO HIGH IN THE MIDDLE AND UPPER INCOME RANGES AND THAT SOCIAL SECURITY AND UNEMPLOYMENT BENEFITS ARE VERY GENEROUS, ESPECIALLY FOR THOSE AT THE BOTTOM OF THE INCOME SCALE. IN EFFECT, "WE HAVE TAKEN AWAY BOTH THE CARROT AND THE STICK."

SPIERS

CONFIDENTIAL

NNN

Message Attributes

Automatic Decaptioning: Z
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC GROWTH, DIPLOMATIC DISCUSSIONS, ECONOMIC ESTIMATES, ANTIINFLATIONARY PROGRAMS, ECONOMIC CONTROLS
Control Number: n/a
Copy: SINGLE
Draft Date: 17 DEC 1976
Decaption Date: 28 MAY 2004
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: ElyME
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1976LONDON20447
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D760464-1156
From: LONDON
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1976/newtext/t19761233/aaaabcqb.tel
Line Count: 207
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EB
Original Classification: CONFIDENTIAL
Original Handling Restrictions: LIMDIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: LIMDIS
Reference: 76 LONDON 20294, 76 LONDON 20292
Review Action: RELEASED, APPROVED
Review Authority: ElyME
Review Comment: n/a
Review Content Flags:
Review Date: 06 APR 2004
Review Event:
Review Exemptions: n/a
Review History: RELEASED <06 APR 2004 by ShawDG>; APPROVED <06 AUG 2004 by ElyME>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
04 MAY 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: HMTREASURY COMMENTS ON THE UK BUDGET
TAGS: EFIN, UK
To: STATE TRSY
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006